

## Comment

### ***Mexico – Tax Measures on Soft Drinks and Other Beverages (DS308)***

### **Prepared for the ALI Project on the Case Law of the WTO**

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In the *Mexico–Soft Drinks* case, Mexico claimed that it was entitled to impose a measure inconsistent with the GATT's national-treatment provisions in response to the refusal of the United States to cooperate in another dispute related to another measure under another agreement. Mexico did not suspend the application of obligations under the NAFTA to products originating in the United States (for instance, by denying preferential tariff treatment of US products). It responded to the United States' failure to cooperate by suspending the application of an obligation assumed towards all Members of the WTO to imported products of all origins. There is no provision of WTO law or any principle of international law that confers the right to suspend the application of obligations assumed under the WTO Agreement towards *all* WTO Members if *one* of them fails to observe another agreement. In their uncontroversial rulings, the Panel and the Appellate Body confirmed this obvious fact.

The two disputes between the United States and Mexico provide a vivid demonstration of the central weaknesses of the NAFTA and WTO dispute settlement procedures. As noted by Davey and Sapir, under the NAFTA dispute settlement procedures invoked by Mexico against the United States, complaints are decided by a five-person Panel chosen from a roster of up to 30 persons either by agreement or, if no agreement can be reached, by lot. Since the roster has not been established, a selection by lot is not possible. As a result, the access to third-party adjudication, originally meant to be automatic, is now effectively available only with the consent of the respondent.

Under the WTO dispute settlement procedures, it is possible to violate, with impunity, obligations under the WTO agreements for considerable periods of time simply by refusing to engage in constructive consultations, unnecessarily complicating the Panel proceedings, appealing the Panel report on frivolous grounds,

insisting on excessive implementation periods and forcing thereby the complainant to request an arbitrator to determine the length of the implementation period. Only when this lengthy four-stage procedure has been completed, and only if – and as long as – the defendant does not implement the WTO rulings and recommendations, may the complainant request compensation or, in the absence of an agreement on compensation, an authorization to suspend concessions. In respect of the damage incurred during the course of the proceedings, the complainant is given no remedy.

As noted by Davey and Sapir, Mexico imposed antidumping duties on US HFCS exports in June 1997. The United States successfully challenged these duties in a regular WTO dispute settlement proceeding and then again in a compliance proceeding. As a result of these two proceedings, the duties were removed in May 2002. However, in January of the same year, Mexico had replaced the duties by a tax on beverages containing sweeteners other than cane sugar, which also prevented exports of HFCS from the United States to Mexico. This tax was also found to be inconsistent with WTO law in the *Mexico–Soft Drinks* case, and it was finally removed in January 2007. Nine and one-half years lapsed between the institution of the first illegal measure protecting the Mexican sugar producers and the removal of the second illegal measure serving the same purpose.

The NAFTA dispute settlement procedures gave the United States the opportunity to deny Mexico access to third-party adjudication altogether. The procedures to enforce WTO law could be turned by Mexico into a mechanism to escape WTO law for almost a decade. The NAFTA and WTO dispute settlement procedures need to be further developed if they are to assist governments in warding off protectionist pressures as strong as those that tend to influence trade policies on agricultural commodities.

Perhaps because of the dearth of genuine legal issues that arose in the *Mexico – Soft Drinks* dispute, the Appellate Body examined matters that would have arisen under circumstances not present in the instant case. Thus, it examined whether the Panel would have had to deny jurisdiction if the United States had raised the same matter under the NAFTA dispute settlement procedures and was therefore precluded under the ‘exclusion clause’ of NAFTA from having recourse to the WTO procedures. The Appellate Body left the question open. Davey and Sapir conclude that a WTO Panel would have to ignore a claim by the respondent that the complainant has waived its right to recourse to the WTO dispute settlement under a regional agreement.

I fully agree with Davey and Sapir and would like to add some considerations that support their conclusion.

A WTO Panel, like any other international tribunal, has the right to determine its own jurisdiction, and there may well be impediments to the exercise of its jurisdiction. However, since the Panel’s mandate is to examine the matter referred to it exclusively in the light of the provisions of the WTO agreements cited by the parties, it can consider only impediments that arise under WTO law. By limiting

the Panel's mandate to the examination of claims and defenses based on the provisions of the WTO agreements, the drafters of the DSU made clear that the incorporation of other agreements into WTO law is part of the legislative jurisdiction of the membership of the WTO, not part of the judicial functions it assigned to Panels and the Appellate Body. That intention is confirmed by the many provisions contained in WTO agreements that make WTO obligations subject to rights retained under non-WTO agreements, such as the Articles of Agreement of the International Monetary Fund and the OECD understanding on official export credits.

This distribution of jurisdiction is, in my view, a natural consequence of the multilateral nature of WTO obligations. Each Member of the WTO assumes its obligations towards all other Members. Therefore, even if a Panel were to deny jurisdiction on the basis of an agreement between the parties to the dispute, a new Panel could in principle examine the matter at the request of another Member not party to that agreement. As a result, no Member of the WTO can effectively extract itself from its WTO obligations except with the consent of the WTO membership as a whole. If Panels were to accept a defense by a respondent based exclusively on a non-WTO agreement between the parties to the dispute, their rulings would create 'limping' legal relationships: the measure at issue would be declared legal in relation to the complainant, but its legal status in relation to all other Members of the WTO would remain undecided. Legal confusion and uncertainty in trade relations would ensue until a new Panel, at the request of a new complainant, resolves the issue.

By limiting the mandate of Panels to the examination of claims and defenses under WTO law, the drafters of the DSU also took into account the domestic political functions of WTO obligations. Many, if not most, of the provisions of WTO law that Panels and the Appellate Body must interpret prescribe trade-policy conduct that generates economic benefits for the Members abiding by them, irrespective of whether others do likewise. Thus, they discourage the use of inefficient policy instruments to protect domestic producers (such as voluntary export-restraint agreements); they ensure that trade-policy objectives are not pursued through non-trade-policy instruments (for instance by prohibiting technical standards designed to protect a domestic industry); they promote transparent and predictable administration of trade-policy instruments (for example, by setting standards for import licensing and customs valuation procedures); and, finally, they foster institutional coherence in trade policymaking by narrowing the range of permitted policy instruments (thus, the prohibition of discriminatory internal taxes prevents the application of protective fiscal measures under the aegis of ministries other than the trade ministries). Countries joining the WTO seek rights, but not only rights. They also want to imbed their own trade policies in a stable legal framework that helps them resist pressures, both from within and from abroad, to depart from the good-governance standards in trade policymaking. The rule that the WTO provisions to be applied by Panels can be changed only by

the membership as a whole, and not through bilateral agreements, assists governments in warding off those pressures.

This function of WTO law is most clearly reflected in Article 11 of the Safeguards Agreement, which commits Members not to maintain voluntary export restraints and other export or import measures affording protection under agreements concluded with other Members. Through this provision, the Members of the WTO expressed the intent that their own future agreements providing for protectionist measures inconsistent with WTO law should not be given effect in WTO law. By denying Panels the right to consider claims and defenses based exclusively on non-WTO agreements, the drafters of the DSU expressed the same intent. If Panels were to respect the 'sovereign will' expressed by Members in a bilateral agreement waiving the jurisdiction of a WTO Panel, notwithstanding the 'sovereign will' previously expressed in provisions of WTO law that such an agreement should not be given effect in WTO law, then WTO law could no longer be used as a shield against unwanted agreements sought by rent-seeking pressure groups.

I would now like to turn to Davey's and Sapir's proposal that 'the WTO impose the requirement that all regional dispute settlement systems contain provisions giving nonparty WTO members third-party rights in regional disputes'. They believe that there are good *economic* reasons to give WTO members the opportunity to become involved in disputes under the DSU to which they are not original parties. 'The main rationale is that the resolution of disputes tends to generate externalities that affect third parties' and that these externalities can be negative 'as, for instance, when the resolution of a dispute between two Members results in decreased exports by, or increased imports to, a third Member'. Davey and Sapir believe that this justifies also the creation of third-party rights for all WTO Members under regional dispute settlement procedures. They believe that their proposal would 'ensure greater transparency of regional dispute settlement and enable third parties to claim their rights, possibly through WTO action'.

Davey and Sapir do not explain which rights WTO Members could claim as a result of greater transparency in regional dispute settlement proceedings. WTO law currently does not protect Members against negative externalities of regional trade agreements. A regional agreement that covers 'substantially all the trade' between the constituent territories is consistent with Article XXIV:8, irrespective of whether or not there are any negative externalities. An adversely affected Member could of course challenge an agreement that does not meet the 'substantially-all-the-trade' requirement. Translated into economic terms, such a challenge would amount to a request that the parties to that agreement discriminate even more against third parties, including the complainant, which would of course increase the likelihood of negative externalities. Members of the WTO whose trade is adversely affected by a regional agreement are thus not accorded, under WTO law, any rights that could possibly be protected by granting third-party status to WTO Members under regional dispute settlement proceedings.

Davey and Sapir also do not explain what action the WTO should take in respect of any negative externality arising from a regional agreement. The inefficient allocation of the world's resources that negative externalities of regional agreements entail can be dealt with through negotiations between the Members of the WTO aimed at reducing the most-favored-nation tariffs applied by parties to regional agreements. Bilateral negotiations to that effect are frequent and, since the Kennedy Round, the multilateral trade negotiations have also been used for that purpose. Alternatively, they could be addressed through new rules that prevent negative externalities or accord compensatory rights to the adversely affected third Members. The choice between the two approaches depends, according to the Coase theorem, on the transaction costs involved in reaching negotiated solutions.<sup>1</sup> It is therefore, in my view, not at all clear whether the negative externalities arising from regional trade agreements call for any action by the WTO other than providing a forum for negotiations.

Davey and Sapir are not merely proposing greater transparency for WTO Members in dispute settlement proceedings under regional trade agreements. They propose that all WTO Members be granted the right to make their case as third parties under such proceedings because their economic interests might be affected by the result of such proceedings. However, *economic* interests, *by themselves*, are not the basis of third-party rights in international dispute settlement proceedings. Interests of a *legal* nature prompt the granting of such rights. A state that wishes to intervene as a third party before the International Court of Justice must, according to Article 62 of the Statute of the International Court of Justice, demonstrate that it has 'an interest of a *legal nature* which may be affected by the decision in the case'. In WTO dispute settlement proceedings, only Members of the WTO have the right to participate as third parties. They, of course, all have a *legal* interest in third-party participation since they are bound by the law that Panels and the Appellate Body interpret. They frequently choose to make third-party submissions because of the systemic implications of the case. If purely commercial considerations prompt them to do so, they will take into account what systemic implications the acceptance of their own legal arguments would have.

Non-Members of the WTO may have enormous economic interests in the outcome of a WTO dispute, but are nevertheless not legally entitled to present their case to a Panel.<sup>2</sup> This is so because the tasks of WTO Panels do not include the weighing of the economic interests of the Members of the WTO against those of non-Members. In principle, all obligations of the WTO must be observed

<sup>1</sup> I owe this point to my colleague Fernando Piérola.

<sup>2</sup> This does not mean that a Panel may not decide to invite a representative of a non-Member of the WTO to a hearing if it considers that this would provide it with facts or perspectives that it needs to resolve the dispute before it. For instance, the GATT Panel in *European Community – Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region* invited Morocco, then a noncontracting party to the GATT, to be present at its meetings 'on the basis of its considerable commercial interest in the matter' (GATT document L/5776, paragraph 1.7).

irrespective of their economic implications for non-Members. Why give non-Members a right to participate in a WTO proceeding on the sole ground that the Panel's rulings may have economic externalities when any such externalities cannot determine the outcome of the proceedings? By according third-party rights to a non-Member of the WTO in a DSU proceeding, the non-Member is given the opportunity to present legal arguments for the purpose of influencing the legal outcome of the proceeding, even though its rights and obligations under international law would not be affected by that outcome. I fail to see any legal principle that would legitimize the additional costs and delays caused by interventions of states not bound by WTO law in WTO proceedings.

These considerations apply *a fortiori* to third-party interventions by WTO Members in proceedings under regional trade agreements. The fundamental function of regional agreements is to secure for the parties market-access rights denied to all nonparties, which inevitably entails the risk of negative externalities. However, such externalities normally do not determine the scope of preferential market-access rights under regional agreements and must therefore be ignored by the judicial bodies established under them. What would be the purpose of obliging a judicial body to hear statements defending economic interests when that body is not entitled to take those interests into account? In disputes under regional agreements, nonparties are likely to have a strong interest in rulings that mitigate the impact of the preferential market access enjoyed by the parties. What would be the legitimacy of according a right to present legal arguments to a nonparty that has a systemic interest in a biased interpretation of the agreement?

To conclude, one clarification: the question of whether dispute settlement proceedings under regional agreements should be more transparent and that of whether economic interests, by themselves, justify the granting of third-party status to nonparties to such agreements, raise completely different issues. WTO law still provides for confidentiality rules that may have been efficient and appropriate in the context of the voluntary dispute settlement procedures of the GATT, because their results became binding only after all contracting parties to the GATT had accepted them, but these rules have lost their justification in the binding procedures of the WTO. Transparency in a proceeding involving binding third-party adjudication permits the tribunal to demonstrate to the public that it has conducted a fair trial and, as a result, enhances the legitimacy and public acceptance of its rulings and, consequently, the chances of their implementation. Transparency should therefore be introduced in such proceedings irrespective of whether it entails the protection of the economic interests of third parties. For the reasons I have outlined above, economic interests, by themselves, do not – and cannot – determine the right of a third state to present its case before an international tribunal. I therefore consider Davey's and Sapir's linkage between negative externalities of regional agreements and the procedural rights of third parties in dispute settlement proceedings under such agreements to be fundamentally mistaken.